

Internal Revenue Service

Department of the Treasury

UIL:

4942.03.07

Washington, DC 20224

199906053

Contact Person:

Telephone Number:

In Reference to:

OP: E-EO: T: 3

Date:

NOV 18 1998

E.I.N.:

Legend:

R=

S=

U=

V=

W=

X=

Y=

Z=

Dear Sir or Madam:

This is in response to a ruling request, dated September 10, 1998 submitted on your behalf by your authorized representative. You are seeking approval, under section 4942(g)(2)(B)(i) of the Internal Revenue Code (hereafter "Code"), of a set-aside made by you as more fully described below.

X is an organization located in Z that has been recognized as exempt under section 501(c)(3) of the Code and is a non-operating private foundation.

Y is a publicly traded stock corporation with its principal offices and facilities in Z. Approximately 36% of Y's stock is owned by members of U.

X's members, Board of Directors and officers are all either members of U, or current or former officers and/or directors of Y. The majority of X's assets consists of the common stock of Y, and were received as contributions from U, or were purchased with such contributions; in addition, X has received substantial contributions from Y over the years, although it has been X's

283

general practice to distribute on a current basis, to designated charitable donees, the funds it receives from Y. Y is a disqualified person with respect to X within the meaning of section 4946(a) of the Code.

X desires to purchase certain parcels of commercial real estate (the "Properties"), constituting a full city block in Z. Some of the Properties consists of vacant lots, and the rest contain structures used for commercial purposes. The Properties to be purchased are owned by various parties unrelated to X, Y, or U. There is however, one other parcel in the block that is already owned by X, having being purchased earlier (from an unrelated party) in anticipation of the project under discussion. The final parcel in the block, which X does not intend to purchase, is owned by Z. It is anticipated that X will spend approximately \$r in acquiring the Properties, including the amount already spent in acquiring the parcel already purchased. The entire block, known as W, has been recently targeted by a local civic advisory committee as a key to rejuvenating an area of downtown Z. This committee also recommended that W be acquired and developed for a higher use, such as a cultural center. W is located adjacent to certain buildings owned by Y, and is within several blocks of substantial other Y facilities.

X's purpose in acquiring the Properties is to ensure that W is in fact eventually devoted to some public use, preferably as a cultural center serving the Z area, or else as a public park or some other public facility. Therefore, at some point not later than five years from now, after the acquisition program is completed, X would most likely donate all the properties (together with the parcel already acquired) to an unrelated section 501(c)(3) organization for the construction of a cultural center. At this point, however, it is not entirely certain whether the cultural center concept is financially feasible and, if it turns out that such a use of W is not feasible, X would likely donate all the Properties (plus the parcel already purchased) to a public body or charitable organization for some other public use. If, for some reason, this alternative too was not feasible, X would itself develop and maintain W for such a public use, such as a park that would be fully open to the public.

X anticipates that it will take as long as five years to determine whether W will be used for the cultural center or for other public purposes. It has been concluded, however, that it would not be prudent to wait until that point to commence or complete the acquisition program, since that could delay the ultimate completion of the project, and could otherwise make the

project more difficult or more expensive to consummate. Therefore, X believes that it would be beneficial for it to purchase the Properties as they become available on the market.

X's plan will require decisions to be made as to the use of the Properties during the period between the date they are purchased and the date that W is donated by X to its ultimate owner or converted by X to its ultimate public use during an interim period (which date will in no event be later than December 31, 2003).

It has been represented that the amount to be set-aside will actually be paid for this specific project within a specified period of time that ends not more than 60 months after the date of the first set-aside.

The set-asides, as described, will actually be expended for acquisition of the parcels not later than December 31, 2003, which is not more than 60 months after the date of the set-aside made by you for this project.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations which are organized and operated exclusively for on or more of the purposes specified therein.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations (hereafter "regulations") provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and includes erection or maintenance of public buildings, and combatting community deterioration.

Section 4941 of the Code imposes a tax on each act of self-dealing, directly or indirectly, between a disqualified person and a private foundation.

Section 53.4941(d)-2(f)(2) of the Foundation and Similar Excise Taxes Regulations (hereafter also "regulations") provides that the fact that a disqualified person receives an incidental or tenuous benefit for the use by a private foundation of its income or assets will not, by itself, make such use an act of self-dealing.

Section 4942 of the Code imposes on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls

28

within the taxable period), a tax equal to 15 percent of the amount of such income remaining undistributed at the beginning of such second (or succeeding) taxable year.

Section 4942(c) of the Code defines the term "undistributed income" as meaning any amount by which the distributable amount for such taxable year, exceeds the qualifying distributions made before the end of that year such time out of such distributable amount.

Section 4942(g)(1)(A) of the Code provides that for purposes of this section, the term "qualifying distribution" means:

(A) any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3)), except as provided in paragraph (3); or

(B) any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B).

Section 53.4942(a)-3(b)(1) of the regulations provides that an amount set-aside for a specific project that is for one or more of the purposes described in section 170(c)(1) or (2)(B) may be treated as a qualifying distribution in the year in which set-aside (but not in the year in which actually paid), if the requirements of section 4942(g)(2) and this paragraph (b) are satisfied. The requirements of this paragraph (b) are satisfied if the private foundation establishes to the satisfaction of the Commissioner that the amount set-aside will be paid for the specific project within 60 months after its set-aside, and:

(i) The set-aside satisfies the suitability test described in subparagraph (2) of this paragraph, or

(ii) With respect to a set-aside made in a taxable year beginning after December 31, 1974, the private foundation satisfies the cash distribution test described in subparagraph (3) of this paragraph.

If the suitability test or cash distribution test is otherwise

286

satisfied, the 60 month period for paying the amount set-aside may, for good cause, be extended by the Commissioner.

Section 53.4942(a)-3(b)(2) of the regulations provides that the "suitability test" is satisfied if the private foundation establishes to the satisfaction of the Commissioner that the specific project for which the amount is set-aside is one that can be better accomplished by the set-aside than by the immediate payment of funds. Specific projects that can be better accomplished by the use of a set-aside include, but are not limited to, projects in which relatively long-term grants or expenditures must be made in order to assure the continuity of particular charitable projects or program-related investments (as defined in section 4944(c)) or where grants are made as part of a matching grant program. Such projects include, for example, a plan to erect a building to house the direct charitable, educational, or other similar exempt activity of the private foundation (such as a museum building in which paintings are to be hung), even though the exact location and architectural plans have not been finalized; a plan to purchase an additional group of paintings offered for sale only as a unit that requires an expenditure of more than one year's income; or a plan to fund a specific research program that is of such magnitude as to require an accumulation of funds before beginning the research, even though not all of the details of the program have been finalized.

Section 53.4944-3(a)(1) of the regulations defines a "program-related investment" as an investment which possesses the following characteristics:

- (i) The primary purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(B);
- (ii) No significant purpose of the investment is the production of income or the appreciation of property; and
- (iii) No purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D).

Section 53.4944-3(a)(2)(i) of the regulations further provides that an investment shall be considered as made primarily for section 170(c)(2)(B) purposes if it significantly furthers the accomplishment of a private foundation's exempt activities, and if the investment would not have been made but for such relationship between the investment and the accomplishment of the foundation's exempt activities.

287

Section 4945(a)(1) of the Code imposes a tax on each taxable expenditure made by a private foundation.

Section 4945(d)(5) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B).

Based on the information submitted, and the representations made therein, we conclude that your set-aside as described herein, will be treated as an amount paid to accomplish one or more 170(c)(2)(B) purposes, and therefore, will be considered a qualifying distribution within the meaning of section 4942(g)(1)(A) of the Code. Furthermore, any benefit(s) redounding to Y as a result of X's activities as described are incidental or tenuous within the meaning of section 53.4941(d)-2(f)(2) of the regulations and would not result in an act of direct or indirect self-dealing.

Accordingly, we rule as follows:

A. The purchase of the Properties, their use during the interim period, and their eventual donation or development as described, will not adversely affect X's status as an organization exempt from taxation under section 501(c)(3) of the Code.

B. The purchase of the Properties, their use during the interim period, and their eventual development or donation as described, will not result in "self-dealing" within the meaning of section 4941 of the Code.

C. The Properties to be purchased by X, and the parcel previously purchased by X, will all be treated as "Program-Related investments" during the interim period within the meaning of section 4944 of the Code.

D. To the extent that X is unable to spend at least \$s in purchasing, maintaining or demolishing the Properties as described, in any single year during the interim period, the excess of \$s over the amount that is in fact spent during that year can be set-aside for future such acquisitions and will be treated as qualifying distributions pursuant to section 4942(g)(2) of the Code.

Pursuant to section 53.4942(a)-3(b)(8) of the regulations, your approved set-aside must be evidenced by the entry of a dollar amount on your books and records as a pledge or obligation to be

288

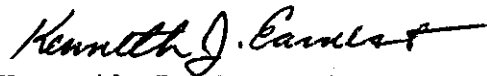
199906053

paid at a future date or dates. Any amount which is set-aside shall be taken into account for purposes of determining your minimum investment return under section 53.4942(a)-2(c)(1), and any income attributable to such set-aside shall be taken into account in computing net income under section 53.4942(a)-2(d).

Please keep a copy of this ruling in your permanent records.

This ruling is directed only to the organization that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited by others as precedent.

Sincerely Yours,



Kenneth J. Earnest  
Acting Chief,  
Exempt Organizations  
Technical Branch 3